THE NEED TO RETURN TO FULL RETAIL ELECTRIC CHOICE

MICHIGAN RETAIL ELECTRIC CHOICE BACKGROUND AND OVERVIEW

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House Energy and Technology Committee

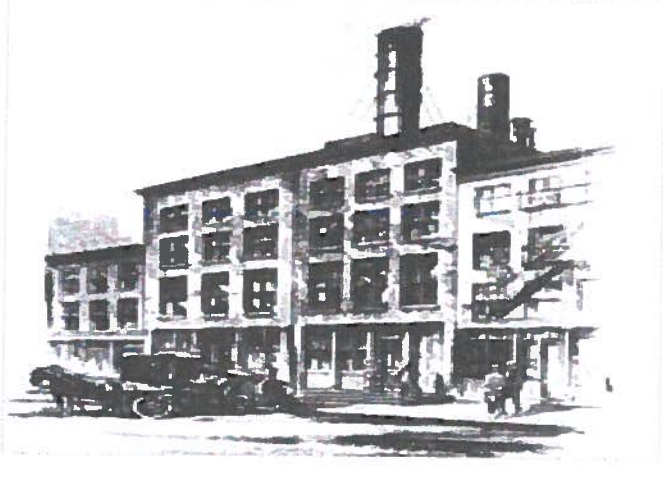
Laura Chappelle/Robert ("Bob") Nelson backgrounds

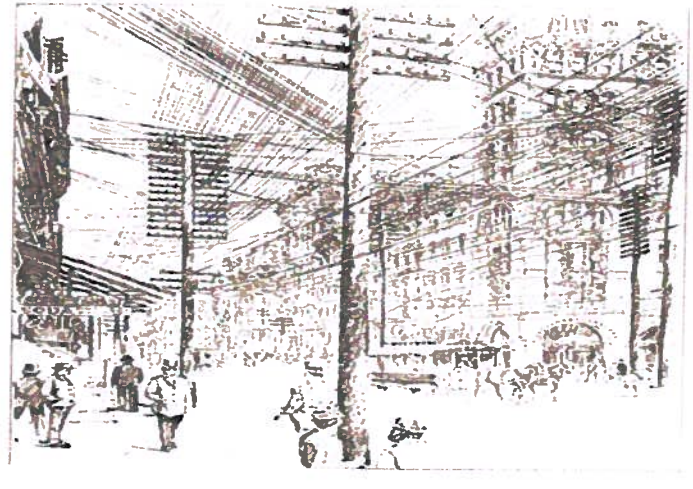
- Laura Chappelle
  - Former Chairman (2001-2003), Commissioner (2003-2007) of the MPSC
  - Adjunct Law Professor (Energy Law and Policy: MSU College of Law ('07-10); Thomas M. Cooley Law School ('07 – current))
  - Deputy Legal Counsel, Regulatory Advisor – Governor John Engler (1997-2001)
  - Policy Advisor (Energy) – House Republican Staff (1996-1997)
  - Attorney – House Speaker Paul Hillegonds (1995-1996)
  - Legislative Advisor – Senator William Van Regenmorter (1992-1995).

- Bob Nelson
  - Former Commissioner of the MPSC (1999-2005)
  - President – Michigan Electric and Gas Association (1987-1999)
  - Director of MPSC Office of Regulatory and Consumer Affairs (1978-1987)
  - Trial attorney, FCC (1970-74)
  - Shareholder, Fraser Trebilcock (2005-2010)
  - Adjunct Professor, MSU College of Law (2007-2010).

U.S. Regulatory History – A (very) Brief Overview: Thomas Alva Edison

- American inventor- originated the concept and implementation of the electric-power generation and distribution systems. (1847-1931)
- 1879: develops the incandescent light bulb.
- Patents his design for an electrical distribution system – uses direct current (DC).
- September 4, 1882: Edison Electric Illuminating Co. opened its first central generating station at Pearl Street in Manhattan (serves 59 customers for about $5 per KWh).
- 1888: Benjamin Harrison became the first President to have electricity in the White House.
- 1889: 154 street railway lightings.



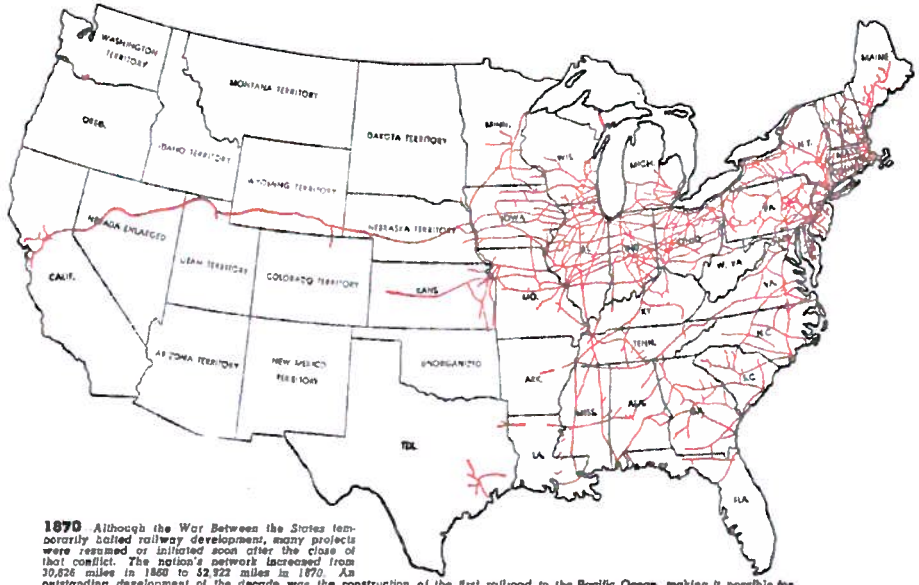


Early Regulatory Authorities

- Early on, there was no regulation of localized electric services.
- Privately-owned utilities competed with each other, sometimes duplicating generation and distribution systems.
- Different regulation and processes amongst cities and towns, and constant battles over "service territories" began to make it difficult for companies to operate.
- City governments eventually stepped in to regulate early central station deployments.
- Some cities were also customers – for street lighting and trolley services. Some became early owners.
- 1900 – municipally-owned utilities accounted for approximately 8% of total U.S. generation.
- Late 1890s invention and use of the electric transformer allowed private utilities to extend their service beyond municipal boundaries.
- Expansion of service signaled the rise of state regulatory authorities.

Regulatory History – Railroads - Grange

- Early state commissions focus on railroads and Grange movement in the Midwest.
- Farmers' movement: originally founded in Washington, D.C. in 1867.
- Mainly focused on railroad transportation costs and abuses.
- 1870s – started fighting the monopoly railroads and exploitative rates of grain warehouses.



1870 *Although the War Between the States temporarily halted railway development, many projects were resumed or initiated soon after the close of that conflict. The nation's network increased from 30,626 miles in 1860 to 52,922 miles in 1870. An outstanding development of the decade was the construction of the first railroad to the Pacific Ocean, making it possible for the first time to travel all the way across the country by rail. Railway development in the Mississippi and Missouri valleys was especially notable during this period.*

State Regulatory Commissions, Generally

- Pre-1870 – advisory bodies – jurisdiction over railroads.
- Six states set up commissions before the Civil War: Rhode Island (1839); New Hampshire (1844); Connecticut (1853); New York and Vermont (1855) and Maine (1858).
- 1871-1874: Illinois, Iowa, Michigan, Minnesota and Wisconsin.
- 1887 (ICC): 25 state commissions.
- 1920: more than two-thirds of the states had regulatory commissions.
- Today: all fifty states plus the District of Columbia, have regulatory commissions.

General Duties of State Commissions

- **Administer** statutory framework in most systems of electric and gas regulation (mostly through administrative hearings).
- **Issue licenses, franchises or permits** for service, construction or maintenance of facilities.
- General **rate-making** authority, including setting, altering or investigating rates.
- Control the quantity and **quality of service.**
- **Assign territory** – through "certificates of public convenience and necessity.

Michigan Public Service Commission -- History

- 1873: **The Michigan Railroad Commission**
  - Single commissioner
- 1909: Expands to a 3-member body
  - Includes electric service
- 1911: Expands to include phone service
- 1919: MRC abolished; new, 5-member Michigan Public Utilities Commission.
- 1939: Changed to Michigan Public Service Commission.
- 1947: Reduced to 3 members, politically- balanced, six-year terms.
  - Includes water, steam, natural gas, petroleum pipelines

1887 – Interstate Commerce Commission

- Early (state) regulations not solving public discontent over rates – federal government acts.

- ICC – significant federal regulatory body created by the Interstate Commerce Act of 1887.
  - First independent gov't agency.
  - 7 members, appointed by the President/consent by Senate.
  - Original purpose was to regulate railroads to ensure fair rates and eliminate rate discrimination.

- Enabling law failed to give it enforcement powers.

Federal Power Commission

The Federal Power Act of 1920 created the Federal Power Commission.

- allowed a regulatory framework to develop.

The Federal Power Act of 1930 established the FPC as a five-member, bi-partisan organization.

** State regulations creating issues with Interstate Commerce Act

- *Missouri v Kansas Gas Co, 265 US 298 (1924)*
- *Public Utilities of Rhode Island v Attleboro Steam and Electric, 273 US 83* (1927)

In 1934, the FPC was directed by Congress to conduct a survey of electric rates throughout the country. The FPC also began its first National Power Survey, analyzing the growth of the nation's electric utilities.

In 1935, Congress expanded the FPC's mission (**The Federal Power Act of 1935**). The FPC began to integrate local utilities into regional systems to increase efficiency.

Federal Power Act – 1935
FERC Jurisdiction

FPA Section 201(b)(1) - FERC has jurisdiction over wholesale energy transactions and interstate sales

1. the "**transmission** of electric energy in interstate commerce" and
2. the "**sale** of electric energy power at wholesale in interstate commerce."

FPA Section 205 Wholesale sale (sale for resale) of electricity

"(a) Just and reasonable rates. All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful"

1945 - 1965
Rapid infrastructure growth

- "Golden Age of electric utilities"
- Demand grows; prices stay relatively low.
- Utilities grow more capital intensive.
- New technologies keep production costs low.
  - New, larger generating plants installed at lower costs per kWh, reflecting economies of scale.
  - New, higher-voltage transmission lines allow plants to be sited closer to coal mines (mouth).
- Utilities start to coordinate with each other.
  - New interconnections help capital investments and fuel costs/reliability.

1960s – Blackouts and Reliability Problems
1970s – Environmental/Financial Crisis

- 1965: Blackout in New York City and most of the Northeast.
- Environmental concerns: public and gov't become concerned about air/water quality – new laws passed for electricity sector
  - New nuclear plants built (essentially no exhaust)
  - New scrubbers installed, fuel switches (adding huge costs)
- 1971: concerned with dwindling reserves of natural gas, the FPC raised price ceilings in an effort to stimulate production.
- 1973: OPEC stops all oil delivery to U.S.
- Financial crisis: increasing costs, declining revenue, lack of load growth, canceled projects.
- 1977: the FPC was converted into FERC.
- IOUs respond by developing coal and nuclear plants.
- Electricity prices rise to unprecedented levels.

1970s: Rise of Competition: Alfred Kahn

- Cornell economist
- Former Chairman of the New York Public Service Commission.
- 1977-78: Appointed by President Jimmy Carter to head the Citizens Airline Board.
- Brought first major experiment with deregulation – airlines.
- Author of ***The Economics of Regulation: Principles and Institutions.***
- Pursued regulatory reforms to improve the efficiency of utility rate structures
  - "peak-load pricing" for retail electricity consumers

Wholesale Generation markets before 1978

- "Vertically Integrated" utilities provide most of their own power (contract for add'l power when needed)
- Vertically integrated utilities sell power at wholesale to other utilities, as well as TDUs ("transmission-dependent utilities," such as municipally-owned or cooperatively-owned utilities).
- Transmission access to outside utilities not widely available.
- i.e., no "competition" in generation market.

PURPA – President Jimmy Carter

- 1978: Congress passes the National Energy Act, which includes the PURPA
  - Public Utilities Regulatory Policies Act of 1978
  - In response to the OPEC oil embargo of the '70s
- Encouraged more energy-efficient and environmentally friendly commercial energy production.
  - Encourages development of cogeneration and small power production facilities
  - Congress hope to reduce demand for (expensive) fossil fuels
  - Creates a "must-buy" provision for utilities (section 210(a))
- Promotes growth of the independent power production sector – gives rise to electric competition
- Promotes greater use of renewable energy
- Biggest result was the prevalence of cogeneration plants

1980s – President Reagan

- "Free markets"
- Continued – Increased - deregulation initiatives that began in Ford and Carter years.
- January, 1981, lifted remaining controls on oil markets
  - By 1986, crude oil prices reached lowest levels since 1973.
- Natural Gas (1989: Natural Gas Wellhead Decontrol Act)
- Airlines (air traffic controllers fired – August, 1981)
- Transportation (1980: Staggers Rail Act; Motor Carrier Act)

Energy Policy Act of 1992 – President George H.W. Bush

- Signifies the emergence of wholesale supply competition
- Congress gives more emphasis to the promotion of competition in electric power industry
  - " . . To use the market rather than government regulation wherever possible both to advance energy security goals and to protect consumers."
- Clarified and broadened FERC wholesale wheeling authority
- Removed some of the restrictions on the growth of the independent power industry imposed by PUHCA
- FERC gains authority to order IOUs to allow non-utility power producers (EWG) access to grid (PURPA).
  - Implemented on a case-by-case basis

Electric Utility Regulation Before Act 141

- Public Act 3 of 1939 (MCL 160.1 *et. seq.*) – "Cost of Service" Regulation

- 1970s – 1980s
  - Utilities motivated to make capital additions
  - High costs of plants (including some plant overruns) borne by captive retail ratepayers
  - Rate cases were contentious and drawn out
  - Significant cross-subsidy from businesses to residential customers
  - Public Act 304 of 1982, in response to rising energy costs, set up a formalized process for collection of fuel and purchased power, which ensured that utilities "passed through" costs

Michigan – 1990s

- Rates for businesses well above national and regional average.
- Electric rates listed as one of top stresses for business costs.
- Some businesses leave the state; others threaten to do so.
- Several other states embarking on various forms of retail electric choice/deregulation.
- 1992: the Association of Businesses Advocating Tariff Equity (ABATE) petitioned the PSC for an experimental retail wheeling program involving industrial customers
  - The MPSC issues an Order granting the request and establishes an experimental retail "wheeling" program;
  - The Michigan Court of Appeals initially upholds this Order;
  - The Michigan Supreme Court reversed the COA and found that the MPSC did not have legislative authority to continue the experimental wheeling program (1999)
- 1996: the Michigan Jobs Commission, under Governor John Engler, issues a report entitled, "A Framework for Electric and Gas Utility Reform," citing Michigan's high electric retail rates and favoring electric retail choice. This report suggested:
  - moving the electric industry in Michigan to competitive markets for the power supply component of electricity service. Transmission and distribution would remain the function of a regulated utility monopoly; and
  - allowing new commercial and industrial loads to purchase electrical generation from anyone willing to supply this service.

Background for Public Acts 141 and 142 of 2000

- 22 other states had pursued electric deregulation.
- Governor John Engler interested in "restructuring" as initial step - not deregulation.
- Executive and Legislative review of PA 3 (1999 – 2000).
- "Choice for those that want it; Protection for those that need it."
- All customers receive choice.
- All three rate classes receive benefits in PA 141/142.

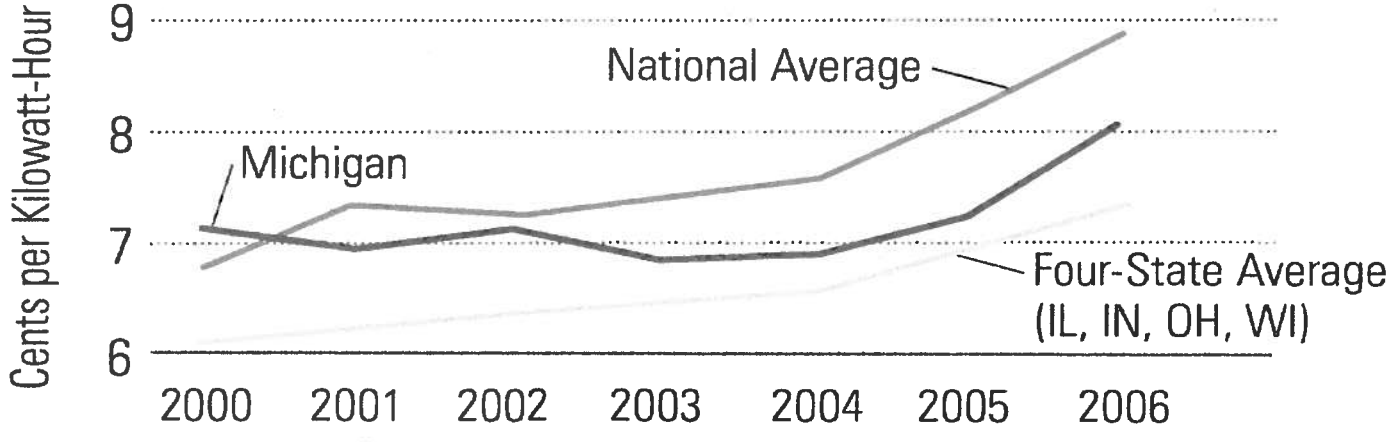
Residential, Commercial, Industrial Customers – PA 141

- Residential customers:
  - Allowed to participate in electric retail choice
  - Rates already at low level, due to "skewing"
  - 5% rate cut
  - Rate "cap" for 5 years
- Commercial customers:
  - Allowed to participate in electric retail choice
  - Rate "cap" for 4 years
- Industrial customers:
  - Allowed to participate in electric retail choice

Incumbent Providers – PA 141 and 142

- "Restructured" markets, not deregulated – Provider of Last Resort remains
- Stranded Costs- Utilities allowed to compete by securitizing uneconomic assets
  - PA 142 allows "full" securitization of *all* stranded costs
    - Detroit Edison: $1.778 billion;
    - Consumers Energy: $469 million.
  - PA 141 allows implementation costs
- Unlike deregulated utilities, incumbent utilities still allowed to file for rate increases
- Michigan rates become competitive after 141 and 142

Average Electricity Prices for Michigan, Surrounding States and United States



Source: U.S. Energy Information Administration

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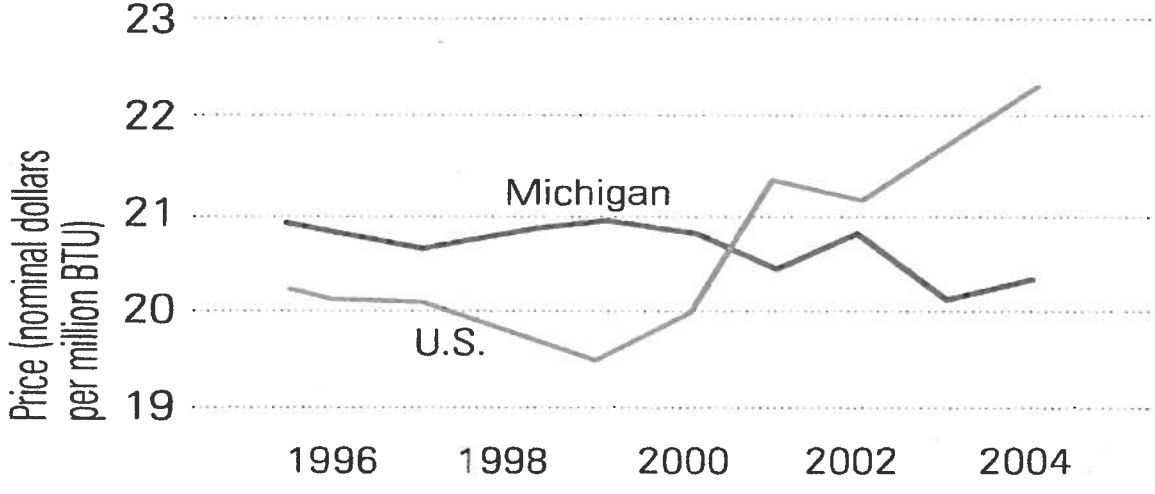
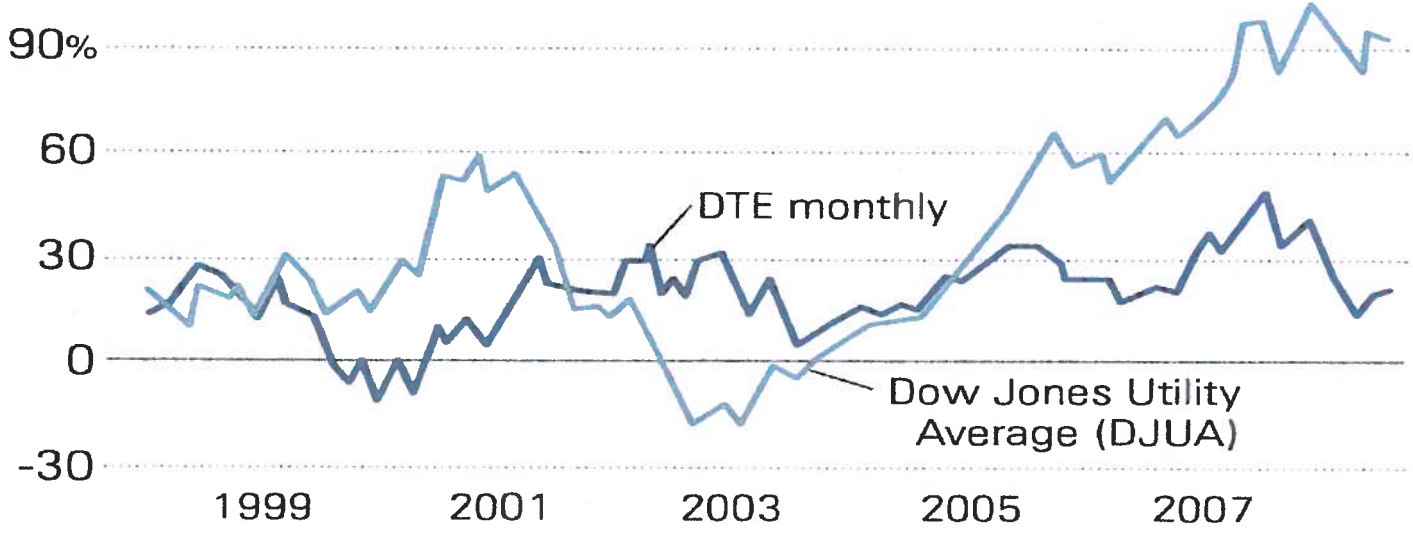
Graphic 3: The Decrease in Michigan's Average Electricity Prices Relative to the U.S. Average Following Partial Deregulation



Source: U.S. Energy Information Administration

Graphic 4: DTE's Above-Average Stock Performance During Peak Competition



Source: The Wall Street Journal. Calculations begin May 8, 1998.

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Misconceptions/Inaccuracies regarding PA 141

- Residentials received no benefit from PA 141 and do not participate in retail choice programs
  - 5% rate cut/rate cap
  - Explosive residential choice in other retail competitive states – PA, IL, OH
    - Must allow and support aggregation
- Incumbent utilities were "hurt" by PA 141
  - Regulatory "compromise" gave utilities guaranteed rate recovery of over $2 billion for the largest utilities' (Detroit Edison and Consumers Energy) agreement to allow electric retail choice;
  - Utility stock/ratings performed well under PA 141 period
- Providers will not build needed infrastructure under "choice" programs
  - Several merchant utility plants built during PA 141
  - These investments fell upon the private investors – not captive ratepayers

Misconceptions/Inaccuracies regarding PA 141, continued

- Incumbent utilities unfairly left as Provider of Last Resort
  - PA 141 and 142 compensated utilities for maintaining captive load (over $2 billion), unlike deregulated states
  - PA 141 meant to be "first step" towards a more open deregulated structure
  - Other retail choice states successfully addressing POLR issues (OH, PA, IL)

- "Bundled" customers pay more for "Choice" customers
  - Ignores fact that stranded costs have already been paid (some would argue several times over)
  - 10% "slice of generation" is sold by utilities via "off-system sales" in the wholesale market
    - revenues flow back to bundled customers through the PSCR

PA 286 of 2008 – Loss of "Balance"

- Choice arbitrarily capped at 10% for all three customer classes, even though utilities keep over $2 billion in securitization and additional stranded costs

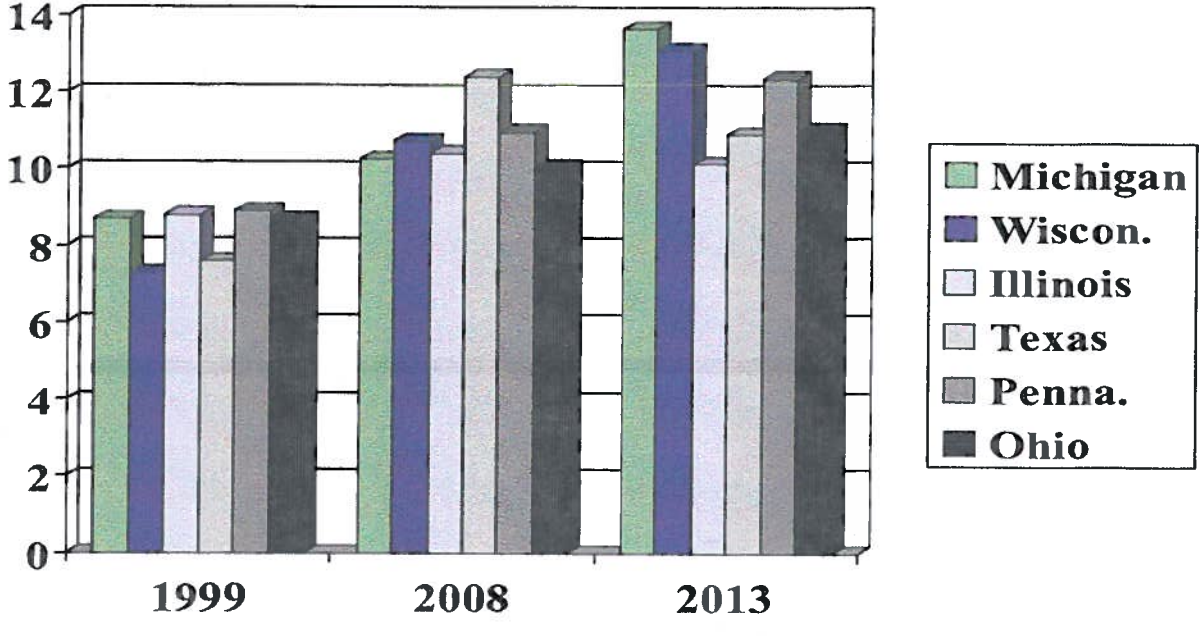
- New "file-and-use" provisions are utility-driven
  - Allegedly address "regulatory lag"
  - Allow yearly rate increases and "self-implementation" after 6 mos
  - Allow Projected Test Year
  - Burden on rates shifts from utilities to customers
    - Customers must now demonstrate no good cause for rate relief

- All rates (commercial) deskewed
  - Significant rate increases for residential
  - Rate increases continuing for commercial/industrial class

- Progress seen toward rate competitiveness under PA 141 has evaporated

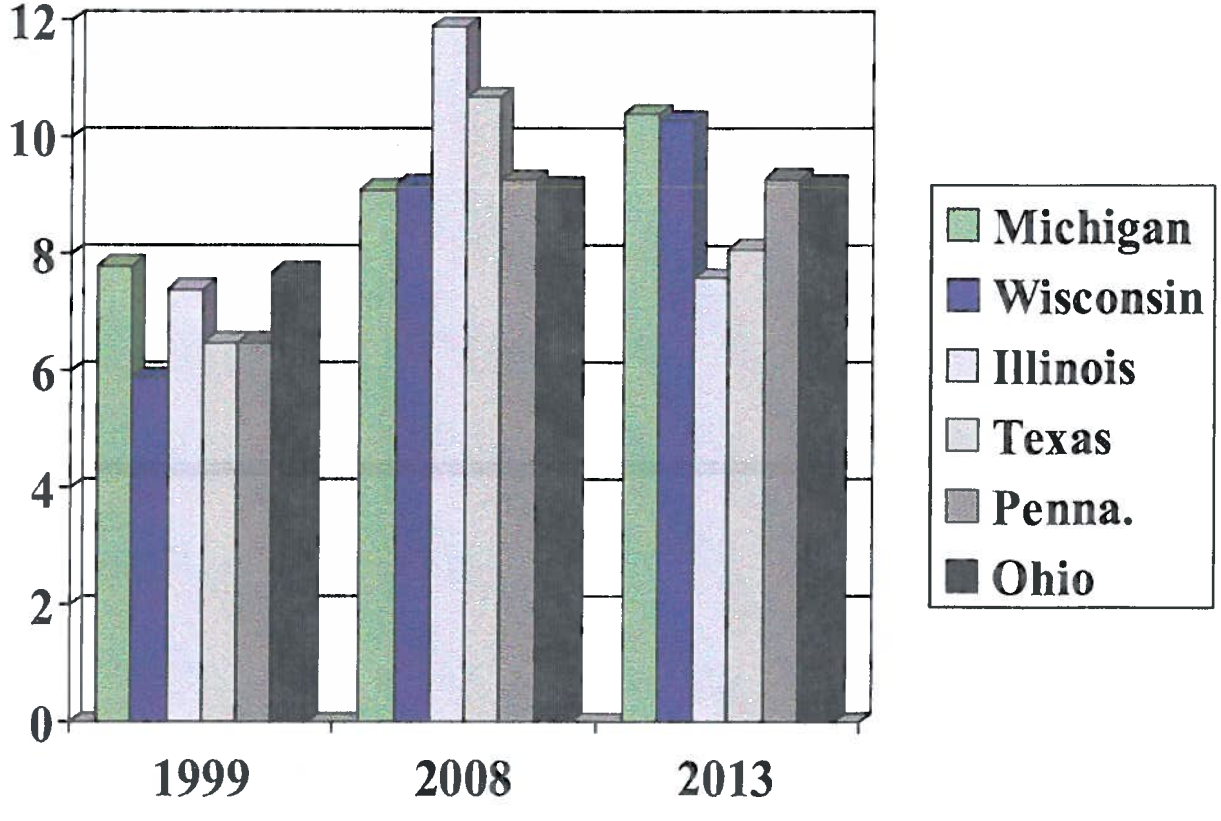
- Over 10,000 Michigan ratepayer customers in "queue" for electric choice

Average Residential Rate in Cents/kWh



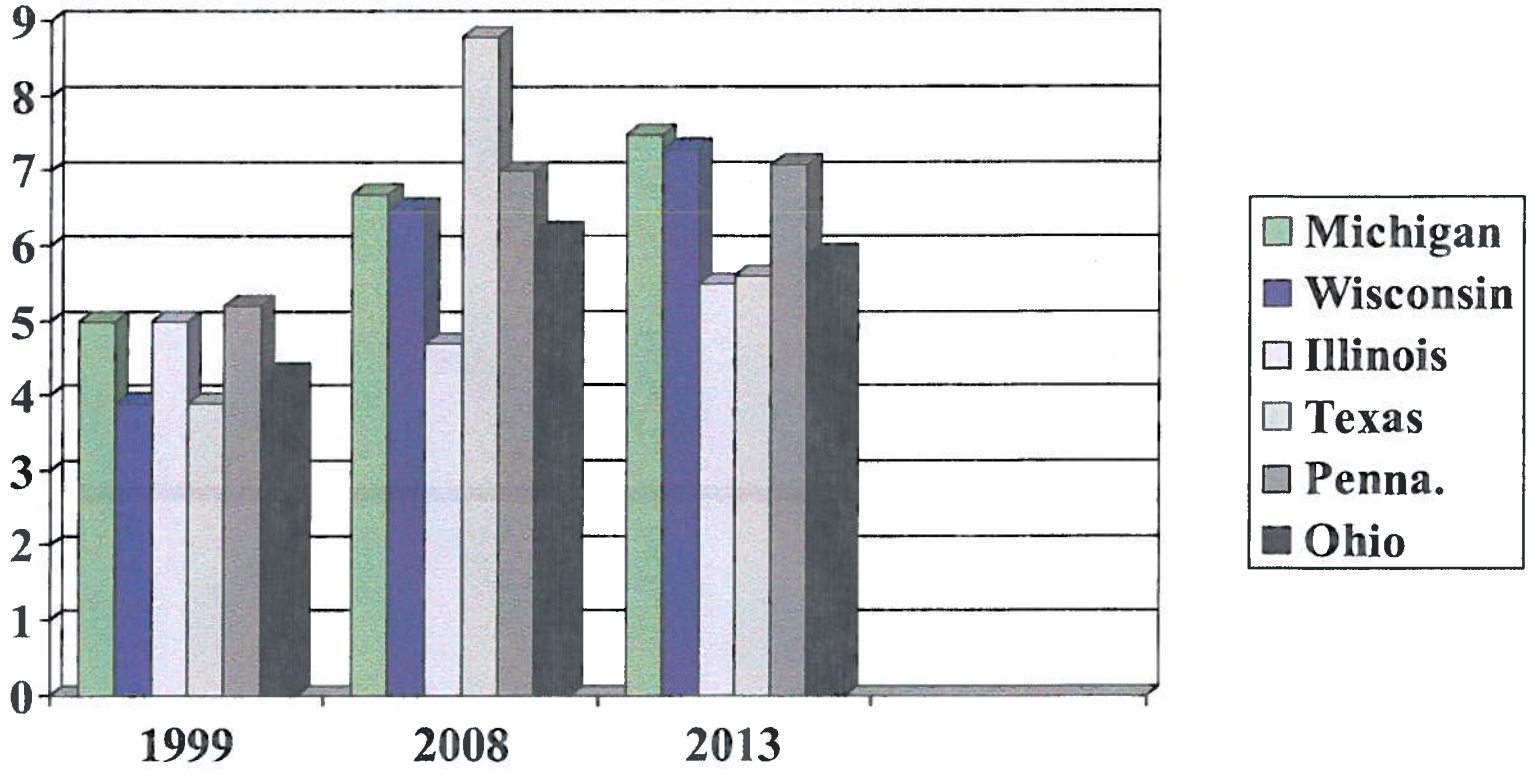
Source-Energy Inform. Admin.

Average Commercial rates in cents/kWh



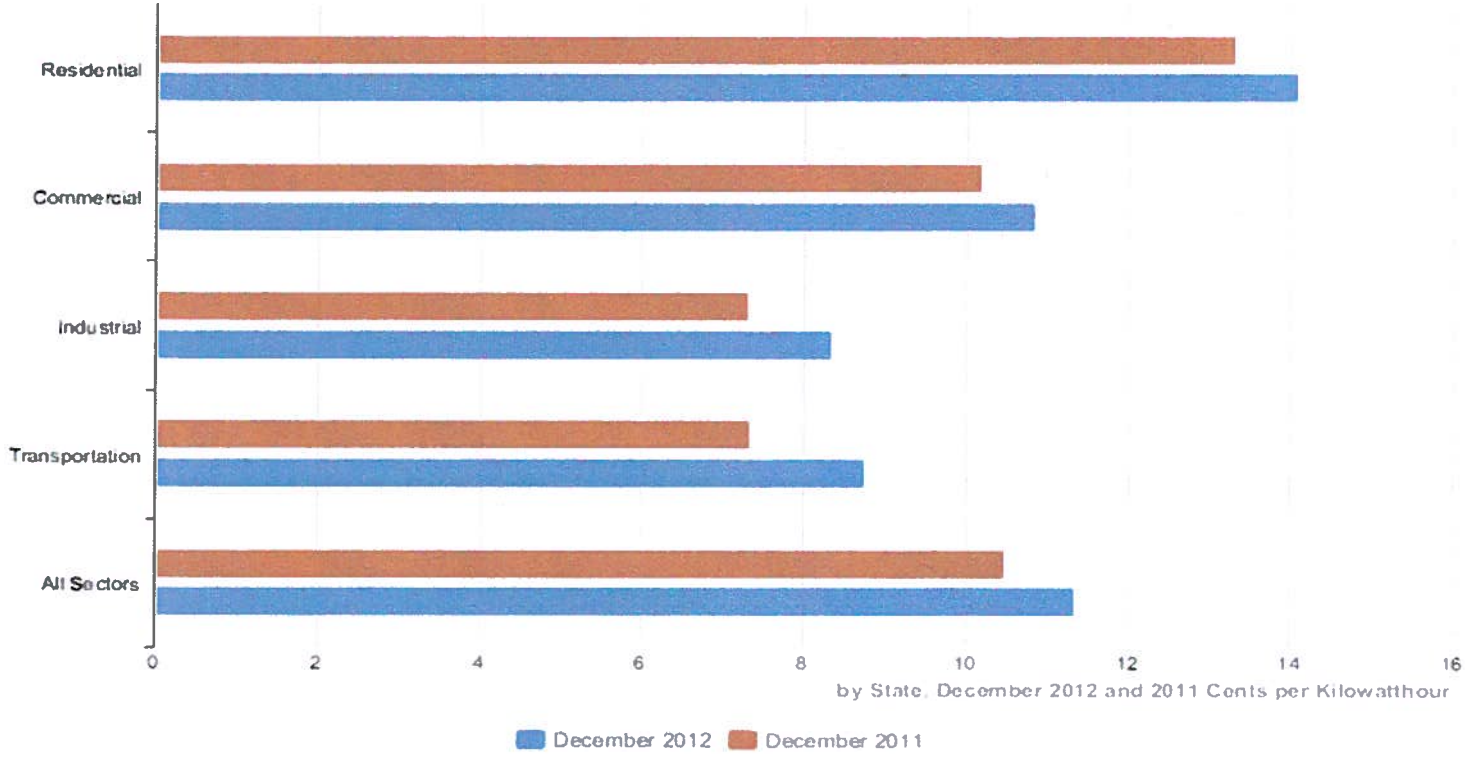
Source: EIA

Average Industrial Rates in Cents/kWh



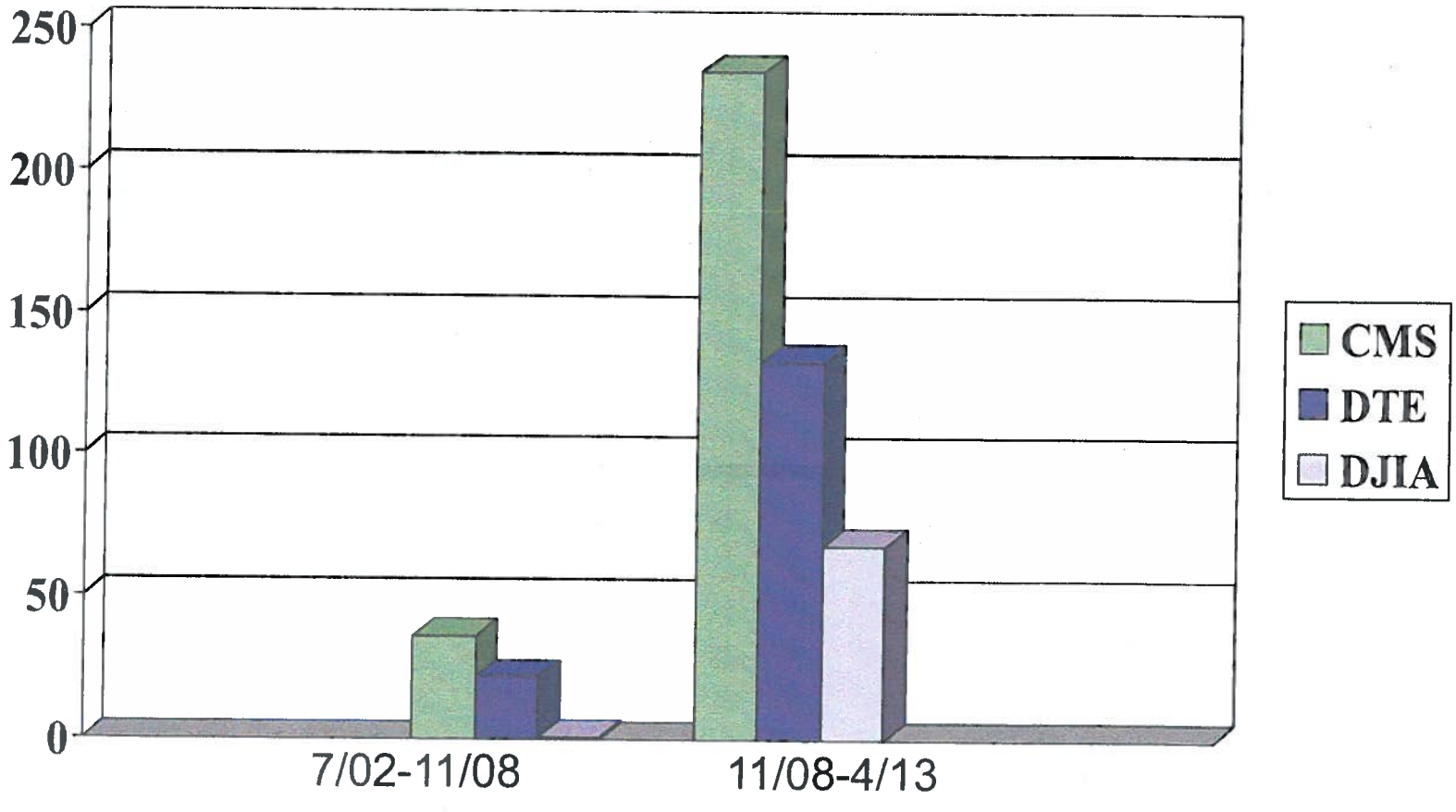
Source: EIA

Table 5.6.A. Average Retail Price of Electricity to Ultimate Customers by End-Use Sector,, Michigan



eia Source: U.S. Energy Information Administration

Percentage Increase in Stock prices from 7/2/02 to 11/6/08 and from 11/6/08 to 4/12/13



Source: Wall Street Journal

Michigan/Wisconsin

Wisconsin

- Coal – 63% net electric generation
  - Imports – Wyoming
- RPS – 10% by 2015
- Significant new baseload generation and transmission infrastructure since 2000
- Prices:
  - Residential: 12.69 kWh
  - Commercial: 9.98 kWh
  - Industrial: 6.91 kWh

Michigan

- Coal – 54% net electric generation
  - Imports: Wyoming, Montana, est. states
- RPS – 10% by 2015
- No new IOU baseload generation since 2000; new IPP peaking plant additions
- Prices:
  - Residential: 14.09 kWh
  - Commercial: 10.87 kWh
  - Industrial: 8.35 kWh

Michigan/Illinois

Illinois

- Nuclear > 40%
- RPS – 9% by 2015; 25% by 2025
- Electric retail choice - 1997
- Prices:
  - Residential: 10.57 kWh
  - Commercial: 7.75 kWh
  - Industrial: 5.60 kWh

Michigan

- Nuclear – 22%
- RPS – 10% by 2015
- Electric retail choice - 2000
- Prices:
  - Residential: 14.09 kWh
  - Commercial: 10.87 kWh
  - Industrial: 8.35 kWh

Need to Establish Full Electric Choice in Michigan

- Regulation – under two different scenarios (pre-PA 141 and under PA 286) - has not worked in Michigan to the benefit of *all* customers.
- Michigan electric rates – in all three customer class sectors – are the highest in the Midwest.
- Individual businesses are again expressing strong concerns about electric retail rates.
- Residential rates are exceptionally high – especially compared with other coal-dependent and peninsula states.
- Utility stock prices have more than doubled since 2008.
- High electric rates detract from goal to attract more businesses to the state.
- Incumbent utilities should be allowed to also participate in electric choice through their affiliates.
- Loss of potential market innovations to benefit customers, as is being seen in other, competitive states.
- Provider of Last Resort issues can be effectively addressed in a number of ways, as has been done in other states.